

## Digest of the Rural Credits Act

[An outstanding achievement of the present democratic administration was the enactment of the new rural credits law. The text of the new bill is too long for reproduction in these pages. Readers of The Commoner will find the following summary, as prepared by the office of information of the United States department of agriculture, an excellent explanation of the various features of the new law.—Ed.]

The Federal Farm Loan act, popularly called the "Rural Credits Law," was signed by the President and became a law on July 17, 1916.

The primary purpose of this act is to promote agricultural prosperity by enabling farmers to borrow money on farm-mortgage security at a reasonable rate of interest and for relatively long periods of time. To attain this object, two farm-mortgage systems are provided: (1) A system operating through regional land banks; and (2) a system operating through joint-stock land banks.

To attract money to the farm loan field, the act provides a method whereby those who have money to lend can find safe investments in the form of debentures or bonds, of small and large denominations, issued by the banks and based on the security of mortgages on farm lands.

These two systems are to be under the general supervision of a Federal Farm Loan board in the treasury department, composed of the secretary of the treasury, as chairman ex-officio, and four members appointed by the President. This board has authority to appoint appraisers, examiners, and registrars, who will be public officials.

### THE FEDERAL LAND BANK SYSTEM

Under the federal land bank system the act provides for federal land banks which make loans, for the first twelve months, exclusively through local national farm loan associations composed of borrowers. These associations shall be shareholders in the banks and in that way the members, who are the borrowers, will share in the profits of the bank. The money for the loans is to come partly from the capital of the banks and partly from the sale by the banks of bonds secured by first mortgages on farm lands. The act defines strictly the purposes for, and the conditions under, which loans are to be made, and requires that the rate of interest charged on farm loans shall not exceed 6 per cent per annum.

### TWELVE FEDERAL LAND BANKS

The United States shall be divided into 12 farm loan districts, and a federal land bank with a subscribed capital stock of not less than \$750,000, each share \$5, shall be established in each district. Each federal land bank may establish branches in its district. Within thirty days after the capital stock is offered for sale it may be purchased at par by anyone. Thereafter, the stock remaining unsold shall be bought by the secretary of the treasury for the United States. It is provided, however, that the government shall not receive any dividends on its stock. Ultimately, it is intended that all the stock in the banks shall be owned by the associations of borrowers, and provision therefore is made in the law for transferring the original stock at par to these associations.

### NATIONAL FARM LOAN ASSOCIATIONS

The act provides for the creation of local national farm loan associations through which it is contemplated that the federal land banks shall make their loans. In the event that a local loan association is not formed in any locality within a year, the Federal Farm Loan board may authorize a federal land bank to make loans on farm land through approved agents. Ten or more persons who own and cultivate farm land qualified as security for a mortgage loan under the act, or who are about to own and cultivate such land, may form such an association, provided the aggregate of the loans desired by the membership is not less than \$20,000. Each member must take stock in his association to an amount equivalent to 5 per cent of the amount he wishes to borrow. This stock the association holds in trust as security for the member's individual loan. The association, in turn, when applying for money from the bank, must subscribe for stock in the bank to an amount equivalent to 5 per cent of the sum it wants to obtain for its members. This stock is held in trust by the bank as security for the loans it makes through the association. If a prospective borrower has no money with which to pay for his

association stock, he may borrow the price of that stock as a part of the loan on his farm land.

Under this plan, then, every borrower must be a stockholder in his local association, and every association a stockholder in its district bank. Each stockholder in an association is liable for the acts of that association up to twice the amount of his stock.

### HOW LOANS ARE OBTAINED

A member of a national farm loan association, before obtaining a loan, must first fill out an application blank supplied to the loan association by the Federal Farm Loan board. This application blank and other necessary papers will then be referred to a loan committee of the association which must appraise the property offered as security. Such application as is approved by the loan committee is then forwarded to the federal land bank and must be investigated and reported on by a salaried appraiser of the bank before the loan is granted. This appraiser is required to investigate the solvency and character of the prospective borrower as well as the value of his land. When a loan is granted the amount is forwarded to the borrower through the loan association.

### CONDITIONS UNDER WHICH LOANS MAY BE OBTAINED FROM FEDERAL LAND BANKS.

The act specifically defines the purposes for which loans may be obtained. These are:

"(a) To provide for the purchase of land for agricultural use.

"(b) To provide for the purchase of equipment, fertilizers and live stock necessary for the proper and reasonable operation of the mortgaged farm; the term 'equipment' to be defined by the Federal Farm Loan board.

"(c) To provide buildings and for the improvement of farm lands; the term 'improvement' to be defined by the Federal Farm Loan board.

"(d) To liquidate indebtedness of the owner of the land mortgaged, existing at the time of the organization of the first national farm loan association established in or for the county in which the land mortgaged is situated, or indebtedness subsequently incurred for one of the purposes mentioned in this section."

Loans may be made only on first mortgages on farm land.

Only those who own and cultivate farm land or are about to own and cultivate such land are entitled to borrow.

No one can borrow save for the purposes stated in the act and those who after borrowing do not use the money for the purposes specified in the mortgage are liable to have their loans reduced or recalled. The secretary-treasurer of each association is required to report any diversion of borrowed money from the purposes stated in the mortgages.

No individual can borrow more than \$10,000 or less than \$100.

No loan may be made for more than 50 per cent of the value of the land mortgaged and 20 per cent of the value of the permanent insured improvements upon it.

The loan must run for not less than five and not more than forty years.

Every mortgage must provide for the repayment of the loan under an amortization plan by means of a fixed number of annual or semi-annual installments sufficient to meet all interest and pay off the debt by the end of the term of the loan. The installments required will be those published in amortization tables to be prepared by the Farm Loan board.

The bank is given power to protect itself in case of default by recalling the loan in whole or in part or taking other necessary action.

### THE INTEREST RATE PAID BY THE BORROWER

No federal land bank is permitted to charge more than 6 per cent per annum on its farm mortgage loans, and in no case shall the interest charged on farm mortgages exceed by more than one per cent the rate paid on the last issue of bonds.

For example, if the bank pays only 4 per cent on an issue of bonds, it can not charge more than 5 per cent for the next farm loans it makes.

Out of this margin of not to exceed 1 per cent, together with such amounts as it can earn on its paid-in cash capital, the bank must set aside certain reserves and meet all its expenses. Any balance or net profits can be distributed as dividends to the loan associations or other stock-

holders. The loan associations, from their bank dividends, after setting aside the required reserves and meeting expenses, can declare association dividends to their members. In this way the profits, if any, will be distributed among the borrowers and will, to that extent, reduce the amount of interest actually paid by them.

### RESTRICTION ON FEES AND COMMISSIONS

The federal land banks are specifically prohibited from charging in connection with making a loan any fees or commissions which are not authorized by the Farm Loan board. The authorized fees need not be paid in advance but may be made part of the loan.

### AMORTIZATION PLAN OF REPAYING LOANS

It has been said that all loans are to be repaid on the amortization plan. This plan calls for a number of fixed annual or semi-annual payments, which include not only all interest and charges due the bank, but the principal as well. These payments are so calculated as to extinguish the debt in a given number of years. After five years the borrower has the right on any interest date to make additional payments on the principal in sums of \$25 or any multiple thereof, thus discharging the debt more quickly.

The table given below illustrates how a loan of \$1,000 bearing interest at 5 per cent would be retired in 20 years by an annual payment of \$80.24. A study of the columns shows how from year to year the interest is reduced and the proportion of the payment which goes to discharge the principal steadily increases. The final payment cancels the debt.

| Annual Periods  | Total annual payment | Interest at 5 per cent | Paid on principal | Amount of principal still unpaid |
|-----------------|----------------------|------------------------|-------------------|----------------------------------|
| 1. . . . .      | \$80.24              | \$50.00                | \$30.24           | \$969.76                         |
| 2. . . . .      | 80.24                | 48.48                  | 31.75             | 938.00                           |
| 3. . . . .      | 80.24                | 46.90                  | 33.34             | 904.67                           |
| 4. . . . .      | 80.24                | 45.23                  | 35.01             | 869.66                           |
| 5. . . . .      | 80.24                | 43.48                  | 36.76             | 832.90                           |
| 6. . . . .      | 80.24                | 41.64                  | 38.59             | 794.31                           |
| 7. . . . .      | 80.24                | 39.71                  | 40.52             | 753.79                           |
| 8. . . . .      | 80.24                | 37.68                  | 42.55             | 711.23                           |
| 9. . . . .      | 80.24                | 35.56                  | 44.68             | 666.56                           |
| 10. . . . .     | 80.24                | 33.32                  | 46.91             | 619.64                           |
| 11. . . . .     | 80.24                | 30.98                  | 49.26             | 570.39                           |
| 12. . . . .     | 80.24                | 28.51                  | 51.72             | 518.67                           |
| 13. . . . .     | 80.24                | 25.93                  | 54.31             | 464.36                           |
| 14. . . . .     | 80.24                | 23.21                  | 57.02             | 407.34                           |
| 15. . . . .     | 80.24                | 20.36                  | 59.87             | 347.46                           |
| 16. . . . .     | 80.24                | 17.37                  | 62.87             | 284.60                           |
| 17. . . . .     | 80.24                | 14.23                  | 66.01             | 218.59                           |
| 18. . . . .     | 80.24                | 10.93                  | 69.31             | 149.28                           |
| 19. . . . .     | 80.24                | 7.46                   | 72.78             | 76.50                            |
| 20. . . . .     | 80.33                | 3.83                   | 76.50             | —                                |
| Total . . . . . | 1,601.80             | 604.89                 | 1,000.00          | —                                |

### FUNDS AVAILABLE FOR LOANS

After a federal land bank has loaned on first mortgage \$50,000, it can obtain permission from the Farm Loan board to issue \$50,000 in farm loan bonds based on these mortgages, sell such bonds in the open market, and use the money thus obtained to lend on other mortgages.

This process of lending on mortgages and selling bonds in issues of \$50,000 may be repeated until bonds to the amount of twenty times the bank's paid-up capital are outstanding. If each bank should have only its required minimum paid-up capital of \$750,000, this plan will provide eventually, if all the authorized bonds of the 12 banks are sold, over \$180,000,000 to lend on first mortgages on farm land. The banks, however, can increase their capital stock above the required minimum and so increase the amount of bonds they can sell, and thus increase the total amount of money available for loans on farm mortgages.

To make these bonds attractive to investors, the bonds, together with the mortgages upon which they are based, are exempted from federal, state, municipal, and local taxation and are made legal investments for fiduciary and trust funds. The capital stock of the federal land banks is also exempt from taxation. Federal reserve banks and member banks of that system are empowered to buy and sell these bonds. They are to be issued in denominations of \$20, \$50, \$100, \$500, and \$1,000.

### ORGANIZATION OF BANKS

The temporary management of the federal land banks is to be in the hands of five directors appointed by the Federal Farm Loan board. As soon, however, as the subscriptions from the loan associations total \$100,000, regular directors are to be appointed as follows: Three district directors, resident in the district, shall be appointed by the Federal Farm Loan board to rep-